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DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND
TREASURY FOR OAISA/RALYEA/CUSHMAN
USTR FOR COLEMAN

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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER MAY 5 2006 ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Trade Deficits Point to Possible Rand Weakness and Increased Inflation;
 - Savings Increase at Year End Although Fall in 2005;
 - Manufacturing Shows Improving Activity for the Second Straight Month;
 - Competition Complaints Increase;
 - Financial Stability Review Warns About Impacts of Interest Rate Rise;
 - Car Sales Increase 12.7% in April; and
 - Retail Sales Continue to Show Strong Growth.
- End Summary.

Trade Deficits Point to Possible Rand Weakness and Increased Inflation

¶2. According to the South African Revenue Service, South Africa's trade deficit narrowed to R2.8 billion in March from R3.9 billion in February as the rand weakened slightly. Exports increased 13% to R29.9 billion in the month, while imports rose 8% to R32.8 billion. On a quarterly basis, the deficit reached R14.6 billion, substantially higher than 2005's first quarter deficit of R 4.7 billion and two thirds the value of 2005's yearly deficit of R21.8 billion. The current account trade deficit increased to 4.2% of GDP in 2005, compared to 3.4% in 2004, and is expected to increase further in 2006. If commodity prices continue to rise, the rand may remain strong; however, concerns exist about whether South Africa can continue to attract enough capital inflows to finance its widening current account deficits. Gold accounts for about 8% of South African exports, and rising gold prices contribute positively to the trade account deficit. However, a higher oil import bill will offset the positive influence of increased gold earnings. Oil imports account for 14.2% of South Africa's imports. If rising oil prices continue along with strong credit growth, the Reserve Bank may increase interest rates. Source: Business Day, and Business Report, May 2.

Savings Increase at Year End Although Fall in 2005

¶3. According to the SA Savings Institute "Savings Barometer," South Africans saved more during the fourth

quarter 2005 although 2005 showed a yearly decrease in savings. The "Savings Barometer," which measures savings across all the sectors of the economy, increased in the fourth quarter by 1.05 index points to 116.88. However, the national savings ratio for 2005 fell to 13.5% compared to 14% in 2004 and 17.6% in 2002. Higher real disposable household income and lower consumer inflation helped improve the savings environment for households in the last quarter of 2005. Lower government spending as a percentage of gross domestic product and the decrease in government's savings. Households are increasing debt as low interest rates and inflation encourage increased credit growth. The debt-to-disposable income ratio for households has increased to 65.6%, while household savings are now 0.2% of disposable income. Source: Business Report, May 2.

Manufacturing Shows Improving Activity for the Second Straight Month

¶4. The Investec Purchasing Managers Index (PMI), compiled by the Bureau for Economic Research at Stellenbosch University, increased to 54.3 during April from 51.5 in March, the second consecutive month that the PMI stayed above the level of 50 (representing the line between expansion and contraction), after dropping below 50 in January and February. The PMI index is a leading indicator of the official data compiled by Statistics SA, which will release its data for March next week. The manufacturing sector accounts for 16% of GDP and is the second-largest sector of the economy after financial and businesses services. The main contributor to the rise in

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the PMI was an acceleration in new sales orders, which indicates the prospect of positive conditions ahead. Output activity also rose for the second month in a row. Increased production did not, however, translate into increased employment, with a decline in the employment subindex of the PMI to 47.9 from 48.2 in March suggesting further job losses in the manufacturing sector. The latest Statistics SA manufacturing data showed a slowing in quarterly growth in February, leading to speculation about possible interest rate reductions. The latest PMI index points to a recovery in manufacturing activity, ruling out future interest rate reductions, especially given South African Reserve Bank Governor (SARB) Mboweni's recent statements that the SARB's bias is now towards higher rates. Source: Reuters and Business Day, May 3.

Competition Complaints Increase

¶5. Based on a study by French and Swiss competition analysts, allegations of anticompetitive behavior in sub-Saharan Africa have increased to 365 in a two-year period from 2002-2004, compared to 252 allegations over the previous six years. South Africa accounted for 30% of the total number of complaints. Most complaints occurred in five sectors: food, telecommunications, petroleum, air transport and chemicals. The study also found that allegations of monopolistic practices, price fixing, and cartels were increasing across the region. According to the study, fewer than 30% involved foreign firms, with most allegations against domestic or regional corporations. Source: Business Day, May 3.

Financial Stability Review Warns About Impacts of Interest Rate Rise

¶6. The latest South African Reserve Bank's (SARB) biannual Financial Stability Review warns about the impact of higher interest rates on consumer debt, reinforcing the

idea that future interest rate hikes are more likely than reductions. The Review stated that although banks and their clients are currently able to cope with record levels of household debt, this might change. The Review pointed out that in the fourth quarter 2005, household debt to disposable income reached 65.6%, compared with 63.5% in the third quarter and 62% in 1997. Low interest rates and inflation allowed households to use a relatively small fraction of their disposable income to service their increased debt. However, the SARB pointed out that signs of change in the ability of borrowers to repay mortgage loans. Mortgage loans overdue (those that are more than 180 days overdue and either inadequately secured or uncollectible) increased by 5.5% in the year to February 2006, while the ratio of overdue mortgage loans to total mortgage advances increased from 1% in the third quarter 2005 to 1.2% in the fourth quarter. SARB expects that the demand for housing will continue to be supported by rises in disposable income, favorable financial conditions and structural changes in the economy, while noting that a sudden increase in the cost of credit could cause problems for overly indebted households. The Review also notes additional potential risks to the financial system stability of high and volatile energy prices, global imbalances and abnormally high residential property prices. Source: Business Report, May 4.

Car Sales Increase 12.7% in April

¶7. According to the National Association of Automobile Manufacturers of SA (NAAMSA), domestic vehicle sales rose in April at an annual rate of 12.7% to 45,635 units, due to continued strong consumer spending. Quarterly domestic sales were 19.5% ahead of the same period in 2005, above expectations and leading industry analysts to revise growth prospects to between 15% and 20% from 10%. Vehicle export sales for the first three months of the year grew by 57.6% to 38,541 units. The vehicle segment accounting for most of the growth last month was heavy trucks, which increased 23% compared with the same month in 2005. Medium commercial vehicles, considered an indicator of small business activity, grew 20.7% compared to April 2005. Passenger cars grew by 13.9% and light commercial vehicles increased by 8.3%. The automotive industry,

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including component manufacturing and after sales products and services, contributes more than 7% to South Africa's GDP. Source: Standard Bank's Motor Alert, May 3; Business Report, May 4.

Retail Sales Continue to Show Strong Growth

¶8. According to Statistics SA, real retail sales grew by 10.4% in February, compared to January's growth of 6.9%. This was the strongest year-on-year increase since the end of 2004, and the first time that positive month-on-month growth was recorded in February since the introduction of the new retail sales series in 1999. Despite the surge, economists expected interest rates to remain unchanged for the rest of 2006 as the CPIX indicator (consumer inflation excluding interest costs on mortgages) was still well within the South Africa Reserve Bank's 3%-6% target range. Growth in retail spending was supported by rising real disposable income levels, lower interest rates, continued personal income tax relief since 1995, welfare and dependency grants to more than 10 million South Africans, and high consumer confidence. Source: Standard Bank's Taking Stock, May 3; Reuters and Business Report, May 4.

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